

INTELLIGENCE HIGHLIGHTS - WEEK OF 4 MAY - 10 MAY 1948

GENERALAustralian-UK policy toward Japan under discussion

A clarification of Australian and UK policy toward Japan is expected as a result of conferences now being held in Canberra between the Chief of the Far Eastern section of the UK Foreign Office and high Australian officials. The UK Foreign Office has reported to the US Embassy in London that the talks are part of an attempt to formulate a joint British Commonwealth approach to the future of Japan and will be followed by consultations with US authorities as to the possibility of reaching an early agreement on the final Japanese settlement.

While no details are yet available on specific subjects under discussion, it is likely that they include the recent/proposals to rebuild Japanese industry and to relax restrictions on Japanese trade and travel—proposals which have been viewed with some misgiving by Australia. The political effect of Australia's contemplated reduction of her occupation force from 7,000 to 3,000 men is probably also under consideration.

Possible restrictions on sale of Japanese heavy equipment to USSR

Possible limitation of sale of Japanese goods of high war potential to the USSR is indicated by a preliminary opinion of the Department of State to the US Political Adviser in Tokyo. The Adviser had reported last month that the Soviet Trade Representative to the Allied Council for Japan is seeking to purchase from Japan such items as rolling stock for Sakhalin railways, marine airless Diesel engines, and steel purse seiner boats; and as payment, the USSR offers coking coal, semi-coke, pulp and similar commodities. The Political Adviser pointed out that there might be political implications involved in the manufacture and sale to the USSR of items that may be used in a re-armament program in that country. He added that SCAP may become subject to criticism if it approves such barter, in view of US policies elsewhere on the export of certain heavy machinery and equipment to the USSR.

The State Department has replied with the preliminary opinion that in order to be consistent with US export licensing policy, it is inclined to disapprove the sale of Japanese goods of high war potential to the USSR. However, it feels that each transaction must be considered on its merits in the light of goods obtainable by Japan from the USSR. Thus, rolling stock useful only in South Sakhalin would add little to Soviet war potential, but adverse publicity would undoubtedly result from such a transaction unless Japan received adequate quantities of essential goods which are not obtainable elsewhere.

-2-

State has also asked the Political Adviser for comments on the possibility of (1) Japanese rolling stock manufacturing capacity being used for European needs if Japan is capable of producing equipment for a standard guage railroads; and (2) Japan producing rails for China in the event that the Canton-Hankow railroad is developed under the China aid program.

Trade Mission from Japan making little progress in the Philippines  
A US trade mission from Japan, which began negotiations with the Philippine Government on 3 May, for an expansion of Japan-Philippine trade, is making little progress. The Philippine attitude is still strongly colored by the war and the new Republic, which now enjoys a favorable world trade position, is already well supplied with the particular items SCAP wishes to sell. The Philippine representatives appear unwilling to enter into an agreement which would ease Japan's economic plight or contribute to its industrial resurgence.

General Daniel Noce, Chief the US Army's Civil Affairs Division, has explained in Manila that SCAP is concerned only with the restoration of trade for the purposes of promoting Japan's economic recovery and living standards, decreasing occupation costs, curbing the spread of communism, and preventing the remilitarization of Japan. However, the Philippine Government is indifferent to any idea of reducing US occupation costs, expressing the belief that the saving effected would be passed on to Europe via ERP instead of to the Philippines. In addition, industrialization in the Philippines has just begun and while that country's needs for construction and essential consumer goods could be met by the Japanese at lower costs, the Philippines is determined to protect its own industries.

JAPAN

USSR resumes Japanese repatriation. On 2 December 1947 the Soviet Member of the Allied Council for Japan notified SCAP that due to "unfavorable climatic conditions" the Repatriation Agreement calling for 50,000 repatriates a month from Soviet-dominated areas would be temporarily suspended as of mid-December. After a lapse of four and a half months the first repatriation ship has landed with 1,952 Japanese nationals from Sakhalin. The USSR has agreed for the first half of May to the repatriation of 14,000 from Nahodka, Siberia and 10,500 from Naoka, Sakhalin. On the basis of this bi-weekly rate, the monthly rate for May will be 49,000 and although this rate is in accord with the Soviet Member's interpretation of the Agreement, it will not be sufficient, unless substantially increased, to bring the monthly average for 1948 to 50,000 per month since no repatriation took place for the first four months of the year. Thirty-two months after V-J Day there remain over 750,000 POWs in Soviet hands including most officers over company rank, high civilian officials and technicians.

SCAP has a long-standing offer to provide sufficient shipping to complete repatriation within five months. It is highly doubtful if the USSR will ever accept SCAP's offer or even average 50,000 a month for 1948. Soviet action is doubtless based on the following considerations: (a) the maintenance of as large a labor force, some of it highly skilled, as possible; (b) the psychological weapon that the possession of hundreds of thousands of hostages provides; (c) the longer the imprisonment the greater the chances of indoctrinating POWs; (d) the belief on the part of the USSR that the retention of a large number of POWs, particularly officers, offers potential military benefit to the USSR.

KOREA

North Korean financial activities in South Korea. The Communists are now seeking new ways to finance their activities in South Korea since the 100-won notes printed by the Japanese and put into circulation by them in pre-surrender days were replaced in April with new Korean notes of the same denomination. It is believed that 900 million won worth of these Japanese notes were in circulation in North Korea or in the hands of North Korean agents in South Korea. The exchange was effected in order to eliminate the infiltration of these notes from North Korea to finance pre-election disturbances in South Korea. The inability of the Communists to continue the use of these notes to finance their activities in South Korea may have prompted the Soviets to speed the development of a new three-way trade arrangement. Reports indicate that the plan involves export of North Korean commodities to Hong Kong either direct or via South Korea. With the foreign exchange thus acquired goods are bought and exported to South Korea. The won proceeds from sale of these goods in South Korea can then be used to promote the Communist program in South Korea.

Although the Soviet authorities must realize that imports from North Korea either directly or via Hong Kong do aid the South Korean economy, they apparently are willing to accept this temporary disadvantage in order to help finance their long range program to control all Korea.

~~SECRET~~~~-4~~CHINAMilitary

The Nationalists in Manchuria have lost contact with all but one of the Chinese Communist columns between Mukden and Changchun. These units are successfully screening their movements into positions for long expected attacks. Previously two Communist columns were reported moving into the Hainmin area and probing attacks were launched on the outskirts of Tiehling and Fushun. Nationalist commander, Wei Li-huang, although admitting that he does not know where the weight of the next Communist attack will fall, indicated he believes that it will be directed at Chinchou and the entrances into North China. Communists in Hopei last week cut the Tientsin-Shanhaikuan sector of the Peining rail line several times, thereby hindering defense efforts along that railway further north.

Meanwhile, two divisions of Yen Hsi-shan's forces were reported on the move east of Shouyang. This gave rise to the speculation that Yen was at last committing his troops to battle, which is doubtful. The Communists were active along a broad arc from Hankou northwest to eastern Kansu. In the Kansu-Sian area, Moslem troops of Ma Hung-kuei and Ma Fu-fang reopened the Sian-Lanchou highway. Although the Nationalist press reported a sweeping victory near Sian, it is apparent that the Nationalist position in this sector has not appreciably improved. Rumors persist that there have been wholesale defections from troops of the Sian Pacification Headquarters. Communist units, which attacked Chenghsien, have withdrawn southwest and have joined other units in a move on the middle Han River. Several points in western Honan and southeast Shensi have already been taken; Nanyang and Lachokou are currently being threatened. Approximately six Communist columns, recently quiescent in west Shantung, are reportedly recrossing the Lunghai railroad in Honan.

Political

Chiang Kai-shek, now in the process of appointing officials in the new constitutional government, apparently will retain Chang Chun in his position as president of the Executive Yuan. Ho Ying-chin, who was expected to hold that position, has apparently been rejected because the Generalissimo refused to accept his reform program. Li Taung-jen, the new Vice President, is not being consulted regarding the new appointments and it appears that Chiang will attempt to balance the opposition voiced through Li's election by maintaining in the top government positions personalities upon whom he has relied in the past, despite their ineffective records. After a conversation with Chiang, Ambassador Stuart finds "it difficult to believe ... that he has any intention of really instituting necessary reforms."

~~SECRET~~

~~SECRET~~

The new Legislative Yuan met for the first time on 8 May with 370 out of 773 members present. The minor parties are boycotting the sessions because of the dispute over the distribution of seats. The name of the new premier will probably not be submitted to the Legislative Yuan for approval until the inauguration of the President and Vice-President now set for 20 May. It appears that formation of a new cabinet will be delayed until then.

Senior Democratic League leaders are planning to split from the leftist elements in the party, according to information revealed by the US representative in Hong Kong. They anticipate repudiating the League manifesto which adhered to the Communist party line and desire US assistance toward relaxation of the League's ban by the National Government.

The British Embassy in Washington has presented to the State Department an Aide Memoire which contains points of interest in connection with the present Sino-American negotiations on the air transport agreement. (See FE/P Weekly 6-12 April 1948.) According to the Memoire, the Anglo-Chinese Convention of 1898 gives the UK sole jurisdiction over the Kowloon New Territories, except for certain exceptions not relevant to this case. The Memoire also points that Article 2 of the Chicago Convention, when applied to Kaitak (Hong Kong airport situated on Chinese territory leased to the UK) defines the latter as UK territory. Furthermore, Shanghai-Kaitak traffic is not Chinese cabotage, a fact which China has admitted tacitly by terms of the Anglo-Chinese Air Transport Agreement which lists Hong Kong as "destination UK territory."

According to Chinese press reports, preparations are being made in Shanghai for a nationwide student protest campaign against US policy in Japan, to start within a few weeks. The student group has been consistently anti-Japanese since the war. The US Consul General believes this might mark the first step in an attempt to stage nationwide anti-Government demonstrations as well as exacerbate general anti-US feeling.

The British Government is demanding £ 300,000 for "shame and damage" resulting from the Shamian incident of 16 January, while the Chinese Government is pressing for the settlement of the Kowloon "squatters incident."

The Dairen Chinese press of 29 April announced the opening of a daily busline service from Dairen to Communist-held Pulantien, Takushan and Antung, points outside the Port Arthur naval base area. This is the first officially recognized overland route to such points since 1946. It opens travel (excluding foreigners) to North Korea and Manchuria and indicates possibility of expansion in overland trade between Soviet-controlled Dairen and North Korea, also with Chinese Communists in Manchuria.

~~SECRET~~

~~SECRET~~

-3-

The State Department has accorded Nanking Embassy freedom of action with regard to diverting the Everett Line SS Coastal Champion, due Shanghai 22 May, to Dairen in order to take US Consular personnel there. US Embassy has informed the Kremlin that the vessel would be so diverted unless visas arrived for transit of consular personnel via Vladivostok. So far there is no Soviet reaction to the notification.

Twenty truck caravans opened the first Inning-Tihua trade in two years.

Economic

Inflation. Chiang Kai-shek held a special meeting with Finance Minister O. K. Yui on 10 May, to draft measures for curbing soaring commodity prices. Chinese Government financial experts are reported to have admitted there is little or no hope of turning back prices under present conditions, and at best could merely slow down the rate of increase.

Currency/Prices. All commodity prices advanced sharply during the past week, while the US \$ broke the CN \$ million mark on the blackmarket. The official "open" US \$ exchange rate has remained unchanged for over a month, and is now only a third of the Shanghai blackmarket rate. April food prices in Mukden doubled those of March. The outstanding CN \$ note issue is reported to be 98.9 trillion as of 1 May, a 41% increase over the previous month.

The Shanghai Market:	US \$ Exchange (Selling Rate)		Wholesale Price of Rice
	Official "open"	Blackmarket	per 172 lb picul
This week (7 May 48)	CN \$328,000	CN \$1,150,000	CN \$4,700,000
Week ago (30 Apr 48)	328,000	810,000	3,850,000
Month ago (7 Apr 48)	328,000	600,000	3,850,000
Year ago (7 May 47)	12,000	27,000	300,000

Foreign Trade-Hong Kong. There was a marked increase during the first quarter of 1948 in the value of exports from Hong Kong to the USSR, while imports from Russia were small. Exports consisted chiefly of metal ores valued at HK \$2.7 million (US \$ 690,000.) Although source does not specify kinds of ores, it is possible that much of these ores represent tungsten, tin and antimony smuggled out of China.

Shipping. US Consul General Hankow has received a report that Wu Kuo-pin, brother to the Shanghai Mayor, is negotiating with the British for transfer of several UK vessels to a Chinese shipping firm to be set up by Wu, for direct Hankow-overseas service. It is reported that UK shipping representatives approve the plan, which is now before the Ministry of Transportation. Foreign flag exclusion on the Yangtze will probably continue.

~~SECRET~~

-7-

SIAM

Phibul Government tackles high cost of living. Several of the seven post-war governments in Siam have fallen as a direct result of their inability to cope with the problem of the rising cost of living. The present Premier, Phibul Songgram, in an attempt to strengthen his position by carrying out a promise of his military coup group, has announced that he is inaugurating an aggressive program designed to decrease the cost of living. A small reduction in rice prices, a 25% reduction in rail freight charges, the opening of cooperative markets, and the projected opening of low-price chain restaurants are some of the more significant features of his program.

Implementation of the program may prove difficult; vigorous prosecution will be impeded by the habitual inertia of the Siamese. The debilitating effect of widespread graft will also prove to be a serious handicap. Sources close to Premier Phibul are reported to feel that the best policy for the present is to accept the existence of graft in a few high places in exchange for efficiency. Phibul is fully capable of utilizing drastic measures to effect such a policy and may be expected to resort to heavy fines and imprisonment if officials fail to carry out his program.

FRENCH INDOCHINA

Bollaert making new efforts to reach political settlement. Reports from both Paris and Saigon indicate that, following his failure, through intermediaries, to effect contact with representatives of Ho Chi Minh and the Viet Minh in Hong Kong, French High Commissioner Bollaert apparently has been forced to utilize General Xuan, French-sponsored President of the Provisional Government of South Vietnam (Cochinchina), in what may be his final effort to reach a political settlement in Indochina. Despite the report that Bollaert was ordered by Paris to take no further action pending instructions, he is evidently attempting to arrive at a face-saving agreement with Xuan, hoping for subsequent approval from the French Government. The new plan allegedly will include the formation of a provisional, and rather limited, central Vietnam Government under Xuan, another Bollaert-Bao Dai conference resulting in the transfer of the negotiations involving Bao Dai to France, and possibly the indefinite postponement of the former Annamite emperor's return to Indochina as head of a new regime.

General Xuan is currently visiting in north and central Vietnam in an effort to encourage anti-Viet Minh elements, and perhaps even non-communist supporters of Ho Chi Minh, to take an active part in the provisional government. The response to date appears to be negative, inasmuch as these groups seem no more willing to cooperate with the pro-French Xuan than they have been with the heads of the French-sponsored and ineffectual Tonkin and Annam Administrative Committees. It is doubtful that any responsible individuals will risk their positions and their lives to support an unstable Xuan government.

28

FRENCH INDOCHINA (continued)

The first public announcement of Xuan's "demands" came from Radio Saigon on 7 May, in a broadcast announcing proposals for "independence" which would include complete internal sovereignty, political and geographic unity, and full economic freedom, but reserving for future negotiations the delicate questions of finance, customs and diplomacy. If a government under Xuan emerges under these circumstances, it is unlikely that the French can avoid the indictment of having created a "puppet" administration or that any such regime can succeed unless the French are willing to make further concessions.

SECRET